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Department of the Treasury
Washington, DC 20224

[Third Party Communication:
Date of Communication: Month DD, YYYY]

Person To Contact: _____, ID No. _____

Telephone Number:

Refer Reply To:
TEGE:EO2
PLR-143212-07
Date:
February 21, 2008

Legend:
Trust =

Plan =

Association =

Dear _____ :

This is in reply to your letter dated August 14, 2007, requesting a ruling that the income of Trust is excluded from gross income under section 115(1) of the Internal Revenue Code and that Trust is not required to file a federal income tax return.

FACTS

Trust was created in conjunction with Plan to help certain public employers pre-fund post employment health and welfare benefits for their employees, employee's spouses and dependents. Health and welfare benefits provided pursuant to Plan may include medical, prescription drug, hearing, dental, vision, life, disability and long-term care benefits. Employer contributions to Trust are used primarily to fund health insurance premiums and premium subsidies. An employer may become a participating employer in Plan by executing a participation agreement and passing a resolution or ordinance adopting Plan. Trust proposes to amend the trust agreement, trust bylaws and plan document to provide that only an employer that is a political subdivision of a state or an entity the income of which is excludible from gross income under section 115 of the Code can become a participating employer. Each participating employer

maintains its own separate account in Trust. Under Plan, a participating employer's benefits program may be fully insured or self funded.

Trust is administered by a program administrator. The duties of the program administrator include accepting deposits to Trust, paying benefits from the assets of Trust and assuring that payments are made in accordance with the provisions of Plan and the Trust Agreement. Association, the creator of Trust, is designated as the first program administrator. Trust proposes to amend its trust agreement, trust bylaws and plan document to provide that the program administrator can be removed and replaced at any time by a two thirds vote of the board of trustees.

Trust is governed by a board of seven trustees. The original board of trustees is selected by Association. Subsequent trustees are elected by the participating employers. Trustees serve a two year term. The program administrator can select a non voting representative to attend meetings of the board of trustees on its behalf.

Trust's income is derived from employer contributions and investment income. The income is used solely for retiree benefits and trust expenses. The Trust Agreement and Plan can be amended by the board of trustees. Plan may be terminated by resolution with the approval of a majority of the Board members. Upon termination of Plan, all assets held in trust will be distributed pursuant to Plan. Trust proposes to amend its trust agreement, trust bylaws and plan document to provide that in no case will any remaining assets in Trust be distributed to an entity other than a political subdivision of a state or an entity the income of which is excluded from gross income under section 115 of the Code.

Trust represents that the Board of Trustees has authorized the amendment of the Plan and participation Agreement so that the following statement will appear in bold type at the top of the first page of Plan and on the first page of every participation Agreement:

"No guaranty that payments or reimbursements to employees, former employees or retirees will be tax-free. The Trust has obtained a ruling from the Internal Revenue Service concerning only the federal tax treatment of the Trust's income. That ruling may not be cited or relied upon by the employer whatsoever as precedent concerning any matter relating to the employer's health plan(s) (including post-retirement health plans). In particular, that ruling has no effect on whether contributions to the employer's health plan(s) or payments from the employer's health plans (including reimbursements of medical expenses) are excludable from the gross income of employees, former employees or retirees, under the Internal Revenue Code. The federal income tax consequences to employees, former employees and retirees depend on the terms and operations of the employer's health plan(s)."

LAW AND ANALYSIS

Section 115

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utilities or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign to properly conduct. In addition, pursuant to section 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Trust provides health benefits to retired employees of participating employers. All participating employers are states, political subdivisions of states, or entities the income of which is excluded from gross income under section 115(1) of the Code. Providing health benefits to current and former employees of such government entities constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Trust performs an essential governmental function within the meaning of § 115(1) of the Code.

The income of Trust accrues to the participating employers in Plan. No private interests participate in or benefit from the operation of Trust. Any distribution of remaining funds in Trust to participating retirees upon the dissolution of Trust satisfies an obligation the participating employers have assumed with respect to providing health

benefits to their employees. The benefit to the participating employees is incidental to the public benefit. See Rev. Rul. 90-74.

Based on the information and representations submitted by Trust, and provided Trust adopts the proposed amendments to its trust agreement, trust bylaws and plan document described above, we hold that, effective on the date the proposed amendments are adopted, the income of Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1). Accordingly, Trust's income is excludable from gross income under § 115(1) of the Code.

Section 6012

Section 6012(a)(2) provides, in general, that every corporation subject to taxation under subtitle A shall make returns with respect to income taxes under subtitle A. In addition, section 1.6012-2(a)(1) of the regulations provides, in part, that every corporation, as defined in section 7701(a)(3), subject to taxation under subtitle A of the code shall make a return of income regardless of whether it has taxable income or regardless of the amount of its gross income.

Section 6012(a)(4) provides, in general, that every trust having for a taxable year any taxable income, or having gross income of \$600 or over, regardless of the amount of taxable income, shall make returns with respect to income taxes under subtitle a. Section 7701(a) and section 301.7701-4 of the regulations define trusts for purposes of section 6012.

If Trust is classified as a trust for federal income tax purposes, no annual income tax return must be filed by Trust pursuant to section 6012(a)(4) since any income realized by Trust is excluded from gross income under section 115(1). However, if Trust is a corporation, as defined in section 7701(a)(3), it will be required to file an income tax return pursuant to section 6012(a)(2).

No opinion is expressed on the classification of Trust as a trust or corporation for federal tax purposes. No opinion is expressed concerning the federal tax consequences of the Trust under any other provision of the Code other than those cited above. In particular, no representation is made regarding the federal tax consequences of contributions to or payments from an employer's health plan(s), including (but not limited to) whether contributions to the plan(s) are excludable from the gross income of employees, former employees or retirees under section 106 and whether payments from the plan(s) (including reimbursements of medical expenses) are excludable from the gross income of employees, former employees or retirees under sections 104 or 105.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

Sincerely,

Sylvia F. Hunt
Assistant Chief, Exempt Organizations
Branch 2
Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures:

Copy of this letter
Copy for § 6110 purposes